TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 02-06

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Application of Tennessee's franchise, excise tax law to a [STATE OTHER THAN TENNESSEE] limited partnership registered to do business in Tennessee when the limited partnership is owned by two single member limited liability companies that are in-turn owned by an S corporation having no Tennessee nexus.

SCOPE

Revenue rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue rulings are advisory in nature and are not binding on the Department.

FACTS

An S corporation having no nexus in Tennessee is the single member of two single member limited liability companies ("SMLLC's"), neither of which have nexus in Tennessee. The two SMLLC's own a [STATE OTHER THAN TENNESSEE] limited partnership ("LP") that is registered to do business in Tennessee. The LP is disregarded for federal income tax purposes.

QUESTION

Which entity or entities are subject to Tennessee franchise, excise tax?

RULING

The S corporation and the SMLLC's will not have nexus with Tennessee and will not be subject to tax. The LP will be subject to Tennessee's minimum franchise tax because it is registered to do business in Tennessee. The LP will be also be subject to franchise, excise tax if it has nexus and does business within Tennessee.

ANALYSIS

Historically, Tennessee's corporate franchise and excise taxes have been taxes that were imposed upon the privilege of doing business in corporate form and the privilege of exercising the corporate franchise in Tennessee. *Memphis Bank & Trust Co. v. Garner*, 624 S.W.2d 551 (Tenn. 1981). Public Chapter 406 of the Public Acts of 1999 expanded application of Tennessee's franchise, excise taxes to other types of business entities. The expansion was further refined in Public Chapter 982 of the Public Acts of 2000. Thus, currently the taxes are imposed upon all "persons"[1] doing for profit business in Tennessee. Tenn. Code Ann. §§ 67-4-2105 and 67-4-2007. The taxes are imposed to compensate the state for the protection of the taxpayer's local activities and as compensation for the benefits received from doing business in Tennessee. *Mid-Valley Pipeline Co. v. King*, 431 S.W.2d 277, 280 (Tenn. 1968). The taxes are imposed on different tax bases. *First American Nat'l Bank v. Olsen*, 751 S.W.2d 417 (Tenn. 1987). The franchise tax has as its base the taxpayer's net worth with the minimum measure being the actual value of the property owned, or property used, in Tennessee. T.C.A. §§ 67-4-2106, 67-4-2108. The excise tax, on the other hand, is based upon a taxpayer's net earnings from business done in Tennessee. T.C.A. § 67-4-2007. Despite the fact that the tax bases are different, the Tennessee Legislature clearly intends that the taxes be taken in tandem and construed together as one scheme of taxation. *See*, *First American National Bank v. Olsen,* 751 S.W.2d 417 at 421 (Tenn. 1987). Thus, if an entity is subject to one of the taxes it will be subject to both.[2]

The S corporation, the SMLLC's and the LP are all "persons" as that term is defined under Tennessee law. Therefore, absent some constitutional prohibition, if any of these entities do business in Tennessee they will be subject to Tennessee's franchise, excise taxes.

The Constitutional limitations on a state's power to tax out of state, or foreign persons, is found in the Due Process Clause of the Fourteenth Amendment and the Commerce Clause of Article 1, § 8. *See, J.C. Penney National Bank v. Johnson,* 19 S.W.3d 831 (Ct.App. 1999). In the context of state taxation, the Due Process Clause "requires some

[1] The term "person" is defined broadly to include "every corporation, subchapter S corporation, limited liability company, limited liability partnership, professional registered limited liability partnership, limited partnership, cooperative, joint-stock association, business trust, regulated investment company, real estate investment trust, state-chartered or national bank, state-chartered or federally chartered savings and loan association." Tenn. Code Ann. § 67-4-2004(16).

[2] The exception being that if an entity is liable for the minimum franchise tax applicable to entities that are registered to do business in Tennessee, the same entity will not necessarily be liable for the excise tax. See, Tenn. Code Ann. § 67-4-2119.

definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Quill Corp. v. North Dakota,* 504 U.S. 298, 306, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992) (quoting *Miller Brothers Co. v. Maryland,* 347 U.S. 340, 344-345, 74 S.Ct. 535, 539, 98 L.Ed. 744 (1054)). The Commerce Clause, however, requires more.[3] The Commerce Clause requires, among other things, that the activity subject to state tax must have a substantial nexus with the state. *See, Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S.Ct. 1669, 51 L.Ed2d 326 (1977) (the case in which the United States Supreme Court established the four principles that must be met before a state may constitutionally impose tax upon interstate commerce).

Substantial nexus under the Commerce Clause is not the same as minimum contacts under the Due Process Clause. *See Quill Corp. v. North Dakota,* supra at 313. To be sure, "the 'substantial nexus' requirement is not, like due process' 'minimum contacts' requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce". *J.C. Penney Co. v. Johnson,* supra at 838 (citing *Quill Corp. v. North Dakota,* supra.).

In *National Bellas Hess, Inc. v. Department of Revenue of Ill.,* 386 U.S. 753, 87 S.Ct. 1389, 18 Led.2d 505 (1967) and *Quill Corp. v. North Dakota,* 504 U.S. 298, 112 S.Ct. 1904, 119 L.Ed.2d 91 (1992), the Supreme Court held that, in the context of a use tax, physical presence was required to satisfy the substantial nexus requirement of *CompleteAuto.* In *J.C. Penny National Bank,* supra, the Tennessee Court of Appeals refused to limit the holding of *National Bellas Hess* and *Quill Corp.* to use taxes.

It is asserted that the S corporation and the two SMLLC's do not have nexus with Tennessee. If that assertion is true then, based upon the foregoing discussion, neither entity will be subject to tax in Tennessee.

The facts do not provide sufficient detail to determine whether or not the LP is, or will be, doing business in Tennessee. A person is said to be doing business in Tennessee if the person purposely engages in any activity within Tennessee with the object of gain, benefit or advantage. Tenn. Code Ann. § 67-4-2004(7)(A). The fact that the LP is registered to do business in Tennessee will subject it to Tennessee's minimum franchise tax. See, Tenn. Code Ann. § 67-4-2119. Mere registration, however, without more, does not rise to the level of "doing business in Tennessee". As such, unless the LP is actually doing business in Tennessee, its tax liability will be limited to the minimum franchise tax.

Even if one assumes that the LP has nexus with and is "doing business" in Tennessee, no facts have been provided that would indicate that the S corporation or the SMLLC's have nexus with Tennessee. It appears that the S corporation's only connection with Tennessee is its ownership of the two SMLLC's that in turn own interests in the LP that is registered to do business in Tennessee. Since limited partnerships are themselves

[3] The Commerce Clause expressly authorizes Congress to "regulate commerce with foreign nations, and among the several States." U.S. CONST. Art. I, § 8 Cl. 3. In addition to this affirmative grant of power, the "negative" or dormant Commerce Clause serves to prohibit state actions that interfere with interstate commerce. *See, Quill Corp. v. North Dakota,* supra (citing *South Carolina State Highway Dept. v. Barnwell Bros., Inc.,* 303 U.S. 177, 185, 58 S.Ct. 510, 514, 82 L.Ed. 734 (1938)).

among the types of entities subject to Tennessee franchise, excise taxation, a foreign entity's ownership of a limited partnership, without more, will not create sufficient nexus to subject the foreign entity to Tennessee franchise, excise taxation. This is true even if the LP is disregarded for federal income tax purposes because for Tennessee tax purposes the LP will not be disregarded. See, Tenn. Code Ann. §§ 67-4-2007(d) and 67-4-2106(c).

Based on the foregoing, absent a lack of substantial nexus or one of the other three constitutional requirements established by the U.S. Supreme Court in *Complete Auto Transit, Inc. v. Brady*, supra, the LP will be subject to Tennessee franchise, excise taxes if it "does business in Tennessee" as that term is defined by Tenn. Code Ann. § 67-4-2004(7)(A). At a minimum, the LP will be required to file a franchise tax return and pay the minimum tax since it is registered to do business in Tennessee. See, Tenn. Code Ann. § 67-4-2119. The S corporation's interest in the SMLLC's and the SMLLC's interest in the LP will not, without more, be sufficient to create the requisite substantial nexus in Tennessee.

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APPROVED: Ruth E. Johnson
Commissioner

DATE: March 18, 2002